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Let's Change GAAS!!! ??? *&# @

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How strange that when we hurl a man into the future, we take few pains to protect him from the shock of change.

Alvin Toffler
Future Shock

This paper is about change, and change is almost always resisted and often controversial. We believe that this is as it should be. Proposed changes should not be blindly accepted nor casually dismissed. Rather, they should be exposed for careful evaluation, critical debate, and, we hope, constructive criticism. Consistent with that belief, we propose that the ten generally accepted auditing standards (GAAS)* be changed to prepare the auditor for the future and to provide some protection from the shock of the changes that future will bring. We think that this future has already struck auditing practice and is sending tremors through its bedrock—GAAS. Our proposal explains why change is necessary, what the change should be, and how it might be implemented.

Why Change GAAS?

Proposing to change GAAS (as the title punctuation suggests) is likely to trigger varying reactions ranging from heated criticism to enthusiastic endorsement. Just where one falls on this continuum is determined by how strongly one agrees with the following views: (1) GAAS continue to provide an ample foundation for guidance on today's audit-related services, (2) audit services not contemplated by GAAS are improper and should be prohibited, and (3) GAAS are sacrosanct, i.e., standards by their nature are (or should be) immutable.

Those at one extreme of the continuum find changing the ten generally accepted auditing standards repugnant and adhere tenaciously to one or more

* The authors are members of the Auditing Standards Board's Levels of Assurance Task Force. Although some of the views the authors express in this paper were inevitably influenced by their involvement with the task force, these views do not necessarily represent those of the task force, Auditing Standards Board, or AICPA.

* Throughout the paper our use of the term "GAAS" is intended to refer only to the ten generally accepted auditing standards. If the term is used in one of its broader connotations such as the ten standards and the SASs, or the ten standards, SASs, and customs of auditing practice, it will be specifically noted in the paper.

of these precepts. Others along the continuum may be skeptical and likely to hold one or more of these views but not as resolutely. Still further along the continuum are the curious who are more open-minded and inquisitive about the need to change GAAS, although they also may find any or all of these three notions tenable. At the other extreme of the continuum are enthusiasts for changing GAAS, of which we are two, who have views diametrically opposed to the three above. In fact, it is our rejection of these three views that makes us discontented with existing GAAS and prompts us to propose a change.

GAAS Are Not Ample

Our primary reason for advocating a change in GAAS is that those standards no longer provide a sufficient foundation for guidance on today's scope of audit services*. The current scope of audit services extends beyond the bounds of the standards.

The proposition that the scope of audit services has outgrown GAAS is easy to substantiate. GAAS were formally adopted by the profession 36 years ago** as a public declaration of its conception of the auditor's responsibility for a single professional service—audits of historical financial statements. Restriction of GAAS to this single audit service is evident from the fact that the evidential matter standard and three of the four reporting standards refer specifically to financial statements. Even the context of the 43-page special report that first introduced the standards to the profession relates entirely to audits of historical financial statements.¹

In addition, the only audit service provided by the profession at the time the standards were developed and introduced was an audit of historical financial statements. These circumstances give historical legitimacy to the singular object of GAAS and make it illogical to conclude that GAAS were intended, or could be interpreted, to apply to any service other than audits of historical financial statements.

Of course, GAAS have not shackled the expansion of audit services. Assurance is now being expressed on a variety of representations other than historical financial statements. This expansion also has taken a second course. Forms and levels of assurance other than that provided for in GAAS are being expressed. Examples of each of these expansions are abundant. CPAs audit internal control systems, specific elements of a financial statement, financial forecasts, computer software, Nielsen ratings, and various types of contests; all of which are representations different than historical financial statements. CPAs also provide assurance other than a positive opinion on such representations as historical financial statements, compliance with contractual or regulatory requirements, and internal accounting control.

The restricted governing power of GAAS coupled with this expansion of audit services present four problems for the profession: (1) audit services exist

* The term "audit services" is used to denote services that involve the basic elements of an audit—a CPA is engaged to examine and express assurance on the credibility of an assertion by one party for use by another party. Thus the expansion referred to excludes the growth of such services as tax and management consulting.

** The first nine of the 10 standards were officially adopted by the AICPA's membership in 1948. The tenth standard (fourth reporting standard) was adopted one year later.

for which there are no general standards, (2) supposedly authoritative guidance (statements on auditing standards) has been established to implement some of these extrinsic audit services on the basis of inapplicable general standards, (3) inconsistencies exist among the presumed authoritative statements on auditing standards for those other audit services, and (4) no standards exist for establishing guidance for future audit services. The gravity of these problems warrants further elaboration.

Problem 1. GAAS were developed to provide standards for the audit of only one specific type of representation—historical financial statements. They were not fashioned in a manner that would restrict the types of other representations a CPA could audit. Thus, current audit services have evolved beyond the bounds of GAAS. Many of these services have no standards to govern their conduct (e.g., reporting on computer software). If the profession is to have a foundation from which to develop guidance for these services, new standards will be necessary.

Problem 2. While some of these new audit services have no authoritative implementation standards concerning them, the remainder are subject to SASs of questionable authority. The Auditing Standards Board has issued a number of SASs pertaining to audit services for representations other than historical financial statements or for forms of assurance other than a positive opinion. For example, statements on auditing standards currently recognize and provide guidance for nearly 20 different limited assurance engagements with another engagement proposed in an SAS exposure draft.² These SASs are ostensibly interpretations of GAAS but, in fact, concern audit services not contemplated by those standards and as a result *extend* GAAS.

Some examples of SASs that have broadened GAAS are: SAS 14 concerning special reports on elements of financial statements, agreed-upon procedures, and compliance with regulatory requirements; SAS 27 concerning required supplementary information; SAS 30 concerning internal accounting control; SAS 38 concerning comfort letters; SAS 42 concerning condensed statements and selected data; and SAS 44 concerning internal control of service organizations.

If pronouncements regarding audit services for other than historical financial statements are to have legitimate authority, they must be based on a set of standards that encompasses those services. Since GAAS do not apply to those engagements, a new set of standards is necessary.

Problem 3. In addition to being of questionable authority, the SASs pertaining to these other audit services also contain inconsistencies, ambiguities, and fragmented professional requirements that contradict one another. These problems have occurred because GAAS were not intended to encompass these types of audit services and, therefore, do not embody all of the concepts necessary for developing such guidance. Even though the Auditing Standards Board and its predecessors tried to implicitly interpret how GAAS should apply to these services, the standards they were interpreting were not designed to apply to those situations. Because GAAS lack the necessary conceptual foundation for such services, they have hindered the development of logical, clear, consistent guidance for them and have promoted discrepancies among SASs. If these discrepancies are to be reconciled, new standards will be

necessary to provide an adequate conceptual basis for guidance on these other audit services.

Problem 4. Since GAAS are limited to audits of historical financial statements, they are impotent as authoritative guidance for future expansions of the audit function. If new audit services relating to representations other than historical financial statements are deemed appropriate, new standards will be necessary to provide guidance and ensure quality. If restrictions are desired on the types of representations on which auditors can express assurance, new standards will have to provide the basis for those restrictions.

Audit Services Should Not Be Confined By GAAS

An argument sometimes mounted against changing GAAS is that the profession should not provide any audit services other than those the standards currently contemplate—examination of historical financial statements. If audits were restricted to only that service encompassed by GAAS, no change in the standards would be necessary.

Theoretically, this argument makes the profession forever hostage to GAAS by restricting the audit services CPAs can provide solely to positive opinions on historical financial statements. The restriction, however, ignores the emergence of auditing as a distinct discipline with legitimate applications beyond historical financial statements and flies in the face of existing practice and demonstrated public demand for new audit services. The argument's most damning flaw, however, is that it presumes that GAAS effectively put restrictions on expansion of the audit function. Yet, as explained in the previous section, neither GAAS nor any other professional standards limit the types of audit services that can be performed by public accountants. Thus, proponents of this argument would actually find it necessary to change GAAS to establish their desired restriction.

Obviously, the profession has already sanctioned audit services beyond positive opinions on historical financial statements. The SASs referred to in the previous section illustrate how, by fiat, the Auditing Standards Board has expanded the audit function beyond that single service. Furthermore, in the absence of standards for determining appropriate expansions of the audit function, CPAs have been free to provide, and have provided, whatever audit services they deem consistent with their professional creed. Thus, the decision has already been made, both at the profession level and by many of its individual members, that audit services should be extended—possibly significantly—beyond examination of historical financial statements.

We concur with that decision. Auditing historical financial statements has become the CPA's birthright and the emergence of auditing as a discipline separate from accounting is the inherited legacy of that birthright. We believe that auditing has many legitimate applications beyond historical financial statements and that broader standards are necessary to assure the controlled development of these new audit services and to provide guidance for them. GAAS are powerless to provide that direction and guidance.

GAAS Are Not Sacrosanct.

Another argument that is sometimes raised in opposition to any proposed

change in GAAS is that standards are too fundamental to be changed. The essence of the argument is that, once established, standards become the profession's constitution and that any tampering with that constitution erodes the profession's credibility, implies that the previous standards were faulty, and marks a change in the fundamental nature of the audit function.

No set of standards is immutable. Constitutions should be and have been amended when the need is demonstrated and justified—so should GAAS. A profession's standards and its services must be commensurate with each other. In fact, it is the incongruity in these two areas that erodes credibility by creating potential pitfalls in the performance of professional services. Standards either must be broad enough to provide for the legitimate evolution of professional services or evolve along with them. Our standards have remained static while our audit services have mutated.

Changing GAAS would not imply that GAAS were faulty. Indeed, GAAS admirably serve their intended purpose, and, if the audit function were to be restricted to positive opinions on historical financial statements, we would not propose any change in the standards. GAAS must be changed because they fail to accommodate the legitimate expansion of audit services; not because they are internally flawed.

Finally, new standards would not have to alter the fundamental nature of auditing. They would simply align with (and perhaps reconcile) contemporary practice and provide for the logical, controlled progression of auditing's role in society. In fact, without new standards, auditing's future development will be subject to caprice and improvisation, almost certainly altering its fundamental nature in an undesirable manner.

What Should the Change Be?

Change can occur in a multitude of forms and degrees. While we advocate the change in GAAS, we believe that GAAS provide a valid model for new standards. Therefore, the changes we recommend are fundamentally revisions and adaptations of GAAS to provide a framework comprehensive enough to direct, accommodate, and endure the evolution of auditing into areas other than positive opinions on historical financial statements.

We believe that sufficiently comprehensive standards must provide basic guidance to the profession concerning the following questions.

1. Under what circumstances can an auditor provide assurance on an assertion?
2. What form(s) of assurance can and should an auditor provide?
3. How many levels of assurance can and should an auditor provide?
4. Is there a minimum scope of involvement below which no assurance should be permitted?
5. What scope of involvement is necessary to enable an auditor to provide a given level of assurance?
6. What should be the structure and wording of an auditor's report in specific assurance engagements?
7. What, if any, different requirements should exist for engagements designed to provide assurance to the general public versus those solely for the benefit of specified parties who participate in establishing the terms of the engagement?

The proposed attest standards (PAS) that follow are organized in the same broad categories as GAAS. Some of the PAS are discussed only briefly because they do not differ significantly from their GAAS counterpart. Therefore, we believe, any objection to them would also pertain to GAAS.

Those PAS that do introduce potential controversy unique to their nature are accorded more extensive discussion. The terms “attest” and “attester” are used with some trepidation. We are aware that the terms imbue the auditor’s role with an aura of exactitude that the profession does not claim. We use the term primarily as a means of distinguishing the auditor’s role under GAAS from his expanded role as a provider of various forms and levels of assurance on various types of representations; not to impose a responsibility for increased accuracy on the auditor. The Appendix contains a listing of PAS and compares them with GAAS.

General Standards

(1) *The Engagement Shall Be Performed by a Person or Persons Having Adequate Technical Training and Proficiency as an Attester.*

This is the existing first general standard modified to be appropriate for different representations and levels of assurance. It recognizes attestation as a separate discipline with a common body of knowledge. This standard protects the client and user of the representation by requiring that the attester be capable of providing the contracted service. It effectively requires that the attester meet the uniform education, experience, and examination requirements of the profession.

(2) *The Engagement Shall Be Performed by an Attester or Attesters Commanding Competence in the Subject Matter of the Assertion on Which Assurance Is To Be Provided.*

This is a new general standard. It is necessary because, as the marketplace extends and broadens the attest function into new areas, attesters will become involved with representations that are outside today’s most widely recognized area of a public accountant’s technical competence—accounting.

This standard would not necessarily require the attester to personally acquire expert competence in the subject matter reported on. It requires that the attester “command” that competence. Interpretive statements of this standard could discuss the use of specialists in a manner similar to SAS 11 and SAS 48 (revision of SAS 3 recently approved by the Auditing Standards Board). The latter provides that an auditor with final responsibility for the engagement must be sufficiently competent in EDP matters to (a) communicate the objectives of the computer audit specialist’s work and (b) review the results of his work to assure that the objectives have been met.

The Auditing Standards Board (or another AICPA authorized body) also could issue, from time to time, interpretive statements to indicate those particular subjects which it believes attesters are in general competent (or incompetent) to independently evaluate. This standard and the one that follows are necessary to set general boundaries for the attest function. Without them, such boundaries will be established solely by such external factors as the marketplace, statutory or regulatory constraints, and general public policy.

(3) *The Attester Shall Accept an Attest Engagement Only If He or She Has Reason To Believe the Following Two Conditions Exist:*

- *The assertions must be capable of evaluation against established and recognized criteria or, in their absence, against reasonable criteria that are stated in the presentation of the assertions in a sufficiently clear and comprehensive manner for a reader to be able to understand them and determine if they are relevant for his or her purposes.*
- *The assertions must be capable of reasonably consistent estimation or measurement; that is, competent people using the same or similar measurement or disclosure criteria should obtain materially similar estimates or measurements.*

This is a new general standard. It is necessary to ensure that attest engagements are performed only when they can be effective and useful. It requires attesters to have a reasonable basis for believing that they are capable of providing meaningful assurance on the assertions before accepting an attest engagement.

As the marketplace increasingly demands the expansion of the attest function into new areas, situations will arise in which attesters are asked to become associated with assertions on which they may not be capable of providing assurance. This standard is desirable because it will force attesters to focus on the question of their ability to provide meaningful assurance before an engagement commences, thereby protecting the client, users, and the public. For the same reason, it will help assuage potential fears of regulators about imprudent expansions of the attest function.

The first condition in this standard requires the attester to have criteria against which to evaluate assertions. However, in new attest areas, there may be no established or recognized criteria for this purpose. Consequently, this standard permits the attester to attest to assertions using stated criteria that are clear and comprehensive enough to permit readers to understand them and assess their relevance for their own purposes. Failing to permit this would result in a standard so rigid that all experimentation in new attest areas would effectively be prohibited. Indeed, such common existing services as compilation and review of financial forecasts and projections would have been prohibited.

The second condition in this standard ensures that the assertion is capable of reasonably consistent estimation or measurement. It also sets boundaries on the types of assertions subject to the attest function.

This condition prohibits an attester from providing assurance on representations that are so subjective that the attester's assurance would add no credibility to the representation and thus be meaningless to an informed user.

(4) *In All Matters Relating to the Attest Engagement, an Independence in Mental Attitude Shall Be Maintained by the Attester or Attesters.*

This is the existing second general standard with the words "assignment" changed to "attest engagement," "is to" changed to "shall," and "auditor or auditors" changed to "attester or attesters." It does not contain any substantive differences from its GAAS counterpart.

(5) *Due Professional Care Shall Be Exercised in the Performance of the Engagement and the Preparation of the Report.*

This is the existing third general standard with the words "is to" and

“examination” changed to “shall” and “engagement.” This standard recognizes the profession’s obligations to users and does not substantively differ from its GAAS counterpart.

Standards of Field Work

(1) *The Work Shall Be Adequately Planned and Assistants, If Any, Shall Be Properly Supervised.*

This is the existing first standard of field work with the word “shall” used in place of “is to” and “are to.” Some would argue that this standard is unnecessary because it is subsumed by the proposed second field work standard and is, therefore, redundant. Those individuals also believe that this standard is primarily related to efficiency and that, because the market forces attestors to adequately plan their engagements to be as efficient as their competition, this standard is unnecessary for purposes of protecting the users of attest reports.

We believe, however, that a significant aspect of this standard relates to the effectiveness of the attestation procedures. Requiring consideration of the adequacy of procedures only near the end of an engagement (as the second proposed field work standard requires) is not as useful in assuring the effectiveness of the attest procedures as this standard.

(2) *Sufficient Evidence Shall Be Obtained To Provide a Basis for the Assurance That Is To Be Communicated in the Attest Report or To Comply with the Arrangements Made with Specified Users.*

This is the existing third standard of field work modified to be appropriate for different levels of assurance and various types of assertions. It also covers engagements tailored to meet the needs of specified users who have participated (directly or through a designated representative) in the establishment of the nature and scope of the engagement.

We believe this standard encompasses the study and evaluation of internal control because this study is an element of accumulating sufficient evidence. Thus, we do not deem it necessary to have a separate field work standard concerning internal control.

Because this standard requires sufficient evidence, it raises the overriding and complex question of what the scope of the attestor’s work should be on a given attest engagement. Furthermore, this question is even more significant today than in the past in view of the expansion of the attest function to new types of assertions and different levels of assurance. Consequently, we will discuss this standard in somewhat more depth than the previous ones.

The nature and extent of the procedures that may be applied on any particular attest engagement is relatively broad. In establishing a proper mix to appropriately restrict attestation risk,* the following generalizations about the validity of evidential matter are cited in the existing auditing literature:

- Evidential matter obtained from independent sources outside an entity provides greater assurance of reliability for the purposes of an attest engagement than evidential matter secured solely within an entity.

* Attestation risk is the risk that the attestor may unknowingly fail to appropriately modify his or her attest report on assertions that are materially misstated. It consists of (1) the risk (consisting of inherent and control risk) that the assertion contains errors that could be material, and (2) the risk (detection risk) that the attestor will not detect such errors.

- Assertions developed under effective internal controls are more reliable than those developed in the absence of internal controls.
- The independent attester's direct personal knowledge, obtained through physical examination, observation, computation, and inspection, is more persuasive than information obtained indirectly.

Thus, in the hierarchy of available attest procedures, those that involve search and verification (e.g., inspection, confirmation, observation, etc.), particularly when using independent sources outside the entity, are generally considered to be more reliable in reducing attestation risk than those involving mere inquiries and comparisons of internal data (e.g., discussions with individuals responsible for the assertion and analytical review). On the other hand, the latter are generally less expensive to apply in practice.

The foremost objective in any attest engagement is to accumulate sufficient evidence to limit attestation risk to a level that is, in the attester's professional judgment, appropriate for the assurance to be provided. In positive opinion engagements, such as audits of historical financial statements, this is accomplished by applying the so-called risk model approach. This approach provides a framework for risk assessment to aid the auditor in planning procedures to reduce audit risk to an acceptably low level and allows the auditor the flexibility of determining the mix of audit procedures that most effectively and efficiently reduces audit risk to that level.

We concur that the risk model concept is appropriate for both positive opinion and limited assurance engagements. However, we think more research and experience in applying the risk model are necessary to determine if it can be applied in limited assurance engagements the same way it is applied in positive assurance engagements.

In positive opinion engagements, the risk model is applied on a case-by-case basis to specific attest engagements. The attester assesses inherent and control risk (or makes assumptions about them) and designs substantive procedures to limit attest risk to an acceptable level. We have concerns that a case-by-case application of the risk model may not work as well in limited assurance engagements.

Our concerns about the risk model are not based on any internal conceptual flaws in the model. The problem lies elsewhere. In our view, the prerequisite for applying the risk model—an acceptable level of attestation risk—may not be susceptible to sufficiently precise definition and communication in limited assurance engagements to allow it to be applied in the same manner as it is used in positive opinion engagements.

To properly apply the risk model, the attester must know in advance the appropriate level of assurance to be achieved in an attest engagement. By its nature, the risk model requires that the assurance goal be specified independently of the procedures to be performed to achieve that assurance.

By way of an explanatory analogy, one could say that the risk model is similar to a compass. A compass is a useful navigational tool only when the navigator has some fairly specific notion of the destination he is supposed to reach. The risk model is a useful attest tool only when the attester has some fairly specific notion of the assurance level he is supposed to reach. The compass cannot decide the destination for the navigator; it can only help guide him to that destination once it is specified. Similarly, the risk model cannot

decide what the level of assurance should be for the attester; it can only help guide him to that assurance once it is specified.

The appropriate assurance objective for any given category of limited assurance engagements is a policy decision to be made at the profession level by a standard-setting body such as the Auditing Standards Board. Such decisions must be made at the profession level to ensure reasonable uniformity in reported assurance among attesters for the same category of limited assurance engagements.

If the standard-setting body is to define the assurance goal in limited assurance engagements in terms usable in the risk model (i.e., independently of procedures), it must do so in either quantitative or qualitative terms. Currently, the profession is both unable and unwilling to quantify levels of assurance because (1) existing attest methods lack the precision to produce reliable quantification and (2) it is perceived that an unacceptable increase in the attester's exposure to business risk may result from quantification.

Short of quantification, the level of assurance must be defined in qualitative terms; for example, "moderate." However, these qualitative terms may provide too vague an assurance target for attesters (e.g., does moderate mean 20 percent assurance, 70 percent assurance, between 30 to 50 percent, or some other range?). Using such terms may fail to provide attesters and users with enough guidance to interpret in a sufficiently clear manner just what level of assurance the profession intends the attester to achieve. Without a more refined definition of assurance, the risk model is powerless to prescribe the necessary risk reduction, and the attester is left without adequate guidance for determining the appropriate scope of work.

In existing limited assurance engagements, the profession has tried to overcome the inability to adequately define a targeted level of assurance that is independent of the risk model by authoritatively establishing one or more required levels of procedures. This prescribed procedures approach does not require an independent definition of assurance to be functional. Presumably, the intended level of assurance is defined by the procedures prescribed. Since the scope of work for any given level of assurance is authoritatively defined, the resulting level of assurance is considered to be defined as well.

Advocates of the procedures approach maintain that both attesters and users are better able to interpret the assurance intended, that attesters have guidance regarding the scope of work necessary to achieve the appropriate level of assurance, and that a clear line is drawn between positive opinion and limited assurance engagements.

In effect, the prescribed procedures approach is an application of the risk model approach at the standard-setting level. The standard-setting body establishes relatively uniform procedures that define the appropriate attestation risk for a specific type of limited assurance engagement instead of individual attesters applying the risk model on a case-by-case basis. In effect, the standard setting body applies the risk model for attesters as a group.*

* Some would argue that the essence of the risk model approach is the flexibility it gives the attester in designing procedures and that application of the risk model at the standard setting level eliminates that flexibility thereby destroying the usefulness of the model. Others believe, however, that the essence of the risk model is its ability to focus the attester's judgment on risk and the effectiveness of the model is not destroyed if that judgment is exercised at the standard setting level rather than by the individual attester.

Returning to the compass analogy, the prescribed procedures approach is similar to a navigational standard-setting body specifying the course to be followed by all navigators for a particular trip. The individual navigators need not know the precise destination in advance; they need only follow the prescribed course to arrive at the destination. Indeed, some advocates of this approach would maintain that the standard-setting body need not even know the precise destination in prescribing the course. They can specify a course, assess what destination the course leads to, and evaluate whether that destination is approximately where they desire all navigators to reach.

We also have concerns about the prescribed procedures approach. Our major concern is that the approach either ignores or assumes constant the inherent and control risks in specific attest engagements. It implicitly assumes that the application of relatively uniform categories of procedures, such as inquiry and analytical review, will yield relatively uniform assurance levels in a given category of limited assurance engagements.

In specific limited assurance engagements, just as in specific positive assurance engagements, there are differences in inherent and control risk. If prescribed procedures are applied without considering these risks, the assurance levels achieved are likely to vary, perhaps widely.

In the final analysis, our concerns about both the risk model and the prescribed procedures approach are rooted in the ability of either of them to yield reasonably uniform assurance levels across a specific category of attest engagements. We believe that reasonably uniform assurance levels are essential to the acceptance and use of limited assurance reports. The profession sorely needs a better understanding of the relative variation in assurance levels under both approaches. Perhaps research and practical experience will provide that understanding in the near future.

Of course, in connection with those engagements performed solely for the benefit of specified users, the attester should be required to perform only those procedures which have been designed, or agreed to, by such users. For this purpose, specified users include those individuals and entities who have participated in the establishment of the nature and scope of the attest engagement either directly or through a designated representative. As a result, such engagements can be tailored completely to the users need, and the proposed attest standard would require the attester to merely comply with the arrangements made with the specified users.

Standards of Reporting

(1) The Report Shall Identify the Assertions Being Reported on and State the Character of the Attest Engagement and Its Conformity with These Standards and with the Arrangements Made with Specified Users, If Any.

This standard is derived from the portion of the existing fourth reporting standard that requires an auditor to indicate the character of the examination. The standard has been modified to be generally applicable to different levels of assurance on various representations and to recognize engagements agreed upon by specific parties. The requirement to indicate the character of the examination could be satisfied by either referring in the report to a specific interpretive standard that describes the scope of the attest engagement or by

delineating the scope of the engagement in the report itself. In the case of engagements with specific parties, the attester would explicitly describe the scope of work as agreed upon with the parties.

(2) The Report Shall State the Attester's Conclusion, in the Form of Either a Positive Opinion or Negative Assurance, as to Whether the Assertions Are Presented in Conformity with Established and Recognized Criteria or, in Their Absence, Stated Reasonable Criteria for Reports Distributed to the Public, the Conclusion Shall Provide the Highest Level of Assurance Permissible by Authoritative Interpretive Standards Consistent with the Work Performed and the Evidence Obtained.

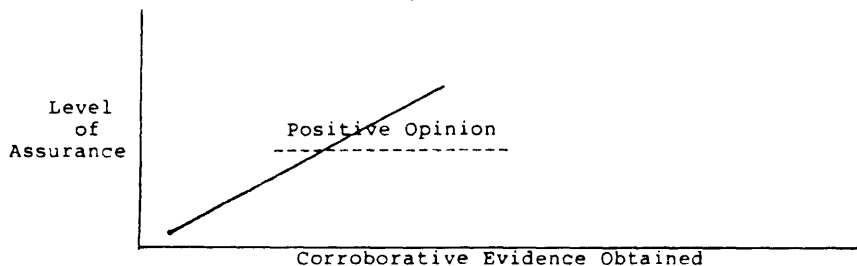
This standard is derived from the first and fourth existing reporting standards, modified to be generally applicable to different levels of assurance on various types of representations. It permits only two forms of attest assurance—positive opinions or negative assurance.

Obviously, there are other forms of assurance that we rejected. These forms can be illustrated by reference to Figure 1.

Figure 1 graphically illustrates that the more corroborative evidence obtained from the scope of an attest engagement, the greater the assurance that can be expressed. Thus, one form for describing the specific level of assurance being provided would be to indicate quantitatively where a particular engagement falls on the diagonal line. For instance, a report might state that the attester was Y percent confident that an assertion was within X percent of the dollars represented (or some other unit of measure). We do not believe, however, that the profession has achieved (nor that it may ever achieve) sufficient sophistication in attest methods to permit reliable quantification of assurance levels in public reports at this time.

Another possible form of assurance would differentiate qualitatively the levels of assurance achieved in limited assurance engagements by varying the strength of the words used in the attester's report. We believe, however, that this alternative runs contrary to the profession's experience which seems to indicate that it is unrealistic and inappropriate to expect users to distinguish between different attest reports prepared by different attesters on the basis of different descriptions of work performed and assurance provided. Consequently, we favor the use of only the positive and negative form of assurance communicated in standard report language and reject attempts to communicate subtle differences in levels of assurance by the use of different (and often hard to define) qualitative terms.

Figure 1



The specific wording of the report would be left to authoritative interpretive pronouncements. We believe, however, that the logical starting point would be the development of a standard attest report that communicates the highest level of assurance an attester would be permitted to provide on whatever assertion he is reporting—the so-called “positive opinion.”* After that development, the standard report wording for negative assurance would follow.

Unfortunately, although the form of reporting is one of the most sensitive aspects of any attest engagement, the profession has probably done most poorly in attempting to define consistent standards for limited assurance engagements in this area. For instance, in some cases reports currently state “nothing has come to our attention” (typical negative assurance language); other reports indicate “we have no adjustments to propose” (sometimes called positive limited assurance); and in still other engagements, no report is given unless there is an exception to report (implicit negative assurance). In addition to these forms of limited assurance, there is at least one engagement in which the report states that specified data “is fairly stated in all material respects” in relation to a bigger unit—the complete financial statements (supplementary information in audit-submitted documents).

Again, we believe that only one form of assurance below a positive opinion should be permitted. This form should be negative assurance because it can be easily adapted to any kind of assertion (financial or otherwise) and is least subject to misunderstanding by report readers.

Although this standard restricts the forms of assurance, it does not explicitly place a limit on the number of different levels of assurance that could be expressed. Even if only one form of limited assurance is permitted—negative assurance—the actual level of assurance it provides will vary depending on the scope of the engagement (which can theoretically vary from 1 to 99 percent of the assurance provided by a positive opinion).

This situation raises two additional considerations. The first is how many different levels of negative assurance should be permitted for limited assurance engagements. The second is whether there is some minimum level of procedures which should always be performed (a floor) for an attester’s assurance to be professional and meaningful to users.

Regarding the first consideration, we believe that, where public reports are involved, the number of appropriate levels of assurance should generally be decided by the standard-setting body through interpretive statements. Although it is our opinion that currently the profession has not developed the attest methods and communication devices to provide more than one level of negative assurance in such circumstances, future developments in these areas may one day make it feasible to provide more than one level of negative assurance. Our proposed standards provide for that possibility.

Restricted reports issued solely to specified users pose a different situation. Since such individuals will have directly participated in establishing

* Theoretically, the positive opinion is not the highest level of assurance that could be achieved. It is based on a concept of reasonableness rather than precise accuracy. A positive opinion, if illustrated on Figure 1, would be a horizontal line somewhere fairly close to the top of the existing diagonal.

the nature and scope of the engagement, the level of negative assurance provided can and should be tailored to their particular needs.

As long as only one level of negative assurance is permitted in public reports, the second consideration will not arise. That is, the authoritatively defined level of assurance (through the risk model, prescribed procedures, or some other approach) also will establish the minimum scope of attest work for a public report. However, should future developments in attest methods make it reasonable for more than one level of negative assurance to be expressed, we would advocate a minimum scope of attest procedures below which no assurance would be expressed.*

This standard also requires the attester's conclusion in public reports to be commensurate with the work performed; that is, the attester is required to express the highest level of assurance permitted by the standards that is consistent with the extent of the work performed. This provision discourages users from inferring more assurance than that specified in the attester's report. This has been a problem in the past when users have asserted that a report can be given greater weight because they know more work has been done than the assurance in the report implies.

(3) The Report Shall State All of the Attester's Substantive Reservations About the Engagement and Assertions.

This standard is also derived from the existing fourth reporting standard, modified to be appropriate for different levels of assurance on various types of representations. It applies equally to public-use and restricted-use reports. The words "reservations about the engagement" refer to any problem that the attester had in complying with the PAS or any interpretive statements or with procedures agreed to by specific parties. The reference to "reservations about assertions" pertains to any reservations about the conformity of the presentation with established and recognized criteria (or stated criteria) including required informative disclosures.*

(4) The Report Shall Contain a Statement of Limitations on the Use of the Attest Report If It Is Intended Solely for Users Who Have Participated in the Establishment of the Nature and Scope of the Engagement.

This is an additional standard created in recognition of the fact that the attest function can encompass engagements to apply procedures agreed upon by the asserter and user (directly or through a designated representative) for their mutual benefit. Reports on such engagements should clearly indicate that they are intended solely for the benefit of the specified parties and may not be useful to anyone else.

* The appropriate minimum should be established by interpretive pronouncement since specific types of engagements are likely to require different attest approaches.

Another issue related to this standard that should be dealt with by interpretive statements is whether it is permissible to express separate conclusions on individual assertions within a presentation of assertions or whether it is permissible to provide any assurance on an individual assertion when the attester has either disclaimed an opinion or issued an adverse opinion on the group of assertions taken as a whole.

* It should be noted that the existing second and third reporting standards are not contained in PAS. Both standards (consistency and informative disclosure) are deemed to be encompassed by the proposed third reporting standard that requires the attester to state a conclusion on conformity with established and recognized criteria.

How Should the Change Be Implemented?

We believe there are four approaches that could be taken to adopt the proposed attest standards. While we discard two of these approaches as unacceptable, we believe further study and consideration must be given to the remaining two before the most appropriate means of adoption can be determined. The four alternatives are:

- Adopt PAS as a replacement of GAAS at the same level of authority following due process.
- Adopt PAS as authoritative standards for all attest engagements, including audits of historical financial statements, following due process but without withdrawing GAAS—in effect, at a higher level than GAAS.
- Adopt PAS as new standards for attest engagements not covered by GAAS at the same level of authority as GAAS following due process.
- Adopt PAS as informal guidance to the Auditing Standards Board without withdrawing GAAS.

The key differences between the four alternatives are (1) whether PAS will replace or supplement GAAS, (2) whether PAS are intended to achieve authoritativeness through due process procedures, and (3) whether PAS will function at the same or at a higher level than GAAS.

We reject the third and fourth alternatives. The latter is rejected because it would treat PAS as, at best, second-class recommendations which could be effectively ignored not only by current and future boards but also by attesters when it becomes desirable.

The third approach is unacceptable because, while PAS would be authoritative, this approach would draw a highly visible yet artificial distinction between audits of historical financial statements and other attest engagements and, thus, would be inconsistent with the basic skills and experience necessary to perform all attest engagements. We believe that there is a common level of skill, training, and experience necessary to perform any attest engagement and, therefore, that PAS should apply to all such engagements.

While we believe that one of the first two alternatives should be adopted, we are undecided as to which approach would be best. The first approach would bring all attest engagements under the same set of standards, where we believe they logically belong. In addition, it would eliminate the potential confusion that might otherwise result from retaining GAAS but establish a single, self-contained definition of the CPA-attester's role in society.

We also believe, however, that the second approach has merit because an elimination of GAAS could dilute the importance of audits of historical financial statements and, more importantly, create potentially serious problems in those jurisdictions that have through statute or regulation granted CPAs a monopoly in that type of attest service. Changing from GAAS to PAS could create legislative problems potentially more serious than having two sets of standards.

Call For Action

The time for change is ripe—perhaps overripe. Without it, the AICPA will find it increasingly difficult to be responsive to the needs of practitioners, and

the profession could lose credibility by failing to establish timely standards to assure the quality of practice in new areas of service.

Inevitably, there will be some who pale at the thought of changing the Decalogue; such a change is always difficult. However, GAAS are outdated. The role of the attester in society has outgrown them, leaving large and undesirable voids in professional standards. And this growth in attest services will continue whether or not the AICPA and ASB acknowledge and accommodate it within professional and ethical standards.

The reality is that the marketplace continues to demand new attest services to meet the new and growing needs of users. This is a healthy and progressive environment for a profession.

The proposed attest standards are designed merely to assure that this expansion of services takes place in an orderly, controlled manner and within professional guidelines that ensure consistency and quality in the delivery of professional services. We need these standards now.

End Notes

1. "Tentative Statement of Auditing Standards—Their Generally Accepted Significance and Scope," Special Report by the Committee on Auditing Procedure, AIA, 1947.

2. For a detailed analysis of these standards see "An Analysis of Professional Standards for Limited Assurance Engagements," Alan J. Winters (an unpublished paper prepared for the Auditing Standards Board).

Appendix

Comparison of Proposed Attest Standards and Generally Accepted Auditing Standards

Proposed Attest Standards	Generally Accepted Auditing Standards
General Standards	General Standards
1. The engagement shall be performed by a person or persons having adequate technical training and proficiency as an attester.	1. The examination is to be performed by a person or persons having adequate technical training and proficiency as an auditor.
2. The engagement shall be performed by an attester or attesters commanding competence in the subject matter of the assertion on which assurance is to be provided.	
3. The attester shall accept an attest engagement only if he or she has reason to believe the following two conditions exist: <ul style="list-style-type: none">• The assertions must be capable of evaluation against established and recognized criteria or, in their absence, against reasonable criteria that are stated in the presentation of the assertions in a sufficiently clear and comprehensive manner for a reader to be able to understand them and determine if they are relevant for his or her purposes.• The assertions must be capable of reasonably consistent estimation or measurement; that is, competent people using the same or similar measurement or dis-	

Proposed Attest Standards

closure criteria should obtain materially similar estimates or measurements.

4. In all matters relating to the attest engagement, an independence in mental attitude shall be maintained by the attester or attesters.
5. Due professional care shall be exercised in the performance of the engagement and the preparation of the report.

Standards of Field Work

1. The work shall be adequately planned and assistants, if any, shall be properly supervised.
2. Sufficient evidence shall be obtained to provide a basis for the assurance that is to be communicated in the attest report or to comply with the arrangements made with specified users.

Standards of Reporting

1. The report shall identify the assertions being reported on and state the character of his attest engagement and its conformity with these standards and with the arrangements made with specified users, if any.
2. The report shall state the attester's conclusion, in the form of either a positive opinion or negative assurance, as to whether the assertions are presented in conformity with established and recognized criteria or, in their absence, stated reasonable criteria. For reports distributed to the public, the conclusion shall provide the highest level of assurance permissible by authoritative interpretive standards consistent with the work performed and the evidence obtained.
3. The report shall state all of the attester's substantive reservations about the engagement and assertions.

Generally Accepted Auditing Standards

2. In all matters relating to the assignment, an independence in mental attitude is to be maintained by the auditor or auditors.
3. Due professional care is to be exercised in the performance of the examination and the preparation of the report.

Standards of Field Work

1. The work is to be adequately planned and assistants, if any, are to be adequately supervised.
2. There is to be a proper study and evaluation of the existing internal control as a basis for reliance thereon and for the determination of the extent of the tests to which auditing procedures are to be restricted.
3. Sufficient competent evidential matter is to be obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statements under examination.

Standards of Reporting

1. The report shall state whether the financial statements are presented in accordance with generally accepted accounting principles.
2. The report shall state whether such principles have been consistently observed in the current period in relation to the preceding period.
3. Informative disclosures in the financial statements are to be regarded as reasonably adequate unless otherwise stated in the report.
4. The report shall either contain an express of opinion regarding the financial statements, taken as a whole, or an assertion to the effect that an opinion cannot be expressed. When an overall opinion cannot be expressed, the reasons therefor should be stated. In all cases where an auditor's name

Proposed Attest Standards

4. The report shall contain a statement of limitations on the use of the attest report if it is intended solely for users who have participated in the establishment of the nature and scope of the engagement.

Generally Accepted Auditing Standards

is associated with financial statements, the report should contain a clear-cut indication of the character of the auditor's examination, if any, and the degree of responsibility he is taking.